Technical Factsheet 170

UK tax valuation rules and reporting

ACCA

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1. INTRODUCTION

1.1 This factsheet aims to provide the user with a summary of the basic tax valuation rules for each of the principal taxes which impinge upon valuation – CGT, IHT, SD, and the application of the ITEPA rules on restricted and unrestricted market value. The factsheet does not cover inter group transactions or corporation tax issues.

1.2. The factsheet also addresses the information standard issue and discusses the latest Case Law in this regard. In addition the factsheet addresses the special purchaser argument.

1.3 Finally this factsheet looks at issues surrounding approaching HMRC and what needs to be included in an opinion that is to be scrutinised by the Revenue.

1.4 By way of background, most of the statute currently in existence with regard to valuation can be traced back to s7(5) FA 1894 with the introduction of Estate Duty. The basic charging provisions have been the subject of review and interpretation by the Courts for in excess of one hundred years.

1.5 This is one of a series of a series of technical factsheets numbered 167 to 171 looking at various valuation issues.

2. CAPITAL GAINS TAX

2.1 The principal charging provisions for CGT are contained within s272-274 TCGA 1992. The basis of valuation is "market value" which is defined as "the price which those assets might reasonably be expected to fetch on a sale in the open market".

2.2 Section 272 (2) contains anti-flooding provision as follows: "In estimating the market value of any assets no reduction shall be made in the estimate on account of the estimate being made on the assumption that the whole of the assets is to be placed on the market at one and the same time".

2.3 The information available in considering a valuation for CGT purposes is defined in Section 273 TCGA 1992 (which applies to unquoted shares and securities) in the following terms: "There is available to any prospective purchaser of the asset in question all the information which a prudent, prospective purchaser of the asset might

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reasonably require if he were proposing to purchase it from a willing vendor by private treaty and at arm's length". This factsheet deals with the application of the statute and its interpretation in Case Law with regard to information standards as a separate heading below.

2.4 It should be borne in mind that Section 19 TCGA 1992 will be in point where assets are disposed of to one or more connected persons (as defined by the Act) through a series of transactions in circumstances where the total value transferred in the series of transactions will exceed the sum of individual transfers. In these circumstances the series of transfers are looked at as a single transfer of the entirety. This statute will apply where small minority interests of shares are disposed of in a series, such that by the end of the series the total number of shares forms a larger holding which may well have a greater value by virtue of the fact that it constitutes an influential minority interest, or a majority interest.

2.5 If shares in unquoted companies (or other assets) are claimed to have become of negligible value under Section 24(2) TCGA 1992, the Act provides that the inspector "may allow the claim and thereupon this Act shall have effect as if the Claimant had sold, and immediately reacquired, the asset for a consideration of an amount equal to the value specified in the claim". The interpretation of this statute by HMRC has changed over the years. The current treatment appears to be that the phrase "negligible value" is in fact an absolute term meaning 'virtually worthless'. Care needs to be taken that the shares, when acquired, actually had a material value, otherwise the claim will fall as the shares cannot have "become" of negligible value – they always would have been. Further details on this can be found on HM Revenue & Customs website , Capital Gains Tax Manuals pages CG13118 to CG13145 which can be found at the following address:

http://www.hmrc.gov.uk/manuals/cgmanual/CG13118+.htm

3. INHERITANCE TAX

3.1 The basic charging provision is contained in Section 1 IHTA 1984 which provides for inheritance tax being applicable "on the value transferred by a chargeable transfer". The transfer must be a "transfer of value", defined as "a disposition made by a person ('the transferor') as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition: and the amount by which it is less is the value transferred by the transfer".

3.2 The relevant valuation provisions are contained in Section 160 IHTA 1984 as follows: "The value at any time of any property shall for the purposes of this Act be the price which the property might reasonably be expected to fetch if sold in the open market at that time: but that price shall not be assumed to be reduced on the grounds that the whole property is to be placed on the market at one and the same time".

3.3 In terms of information the statute (Section 168 IHTA 1984) states that: "It shall be assumed that in the market there is available to any prospective purchaser of the shares or securities all the information which a prudent, prospective purchaser might reasonably require if he were proposing to purchase them from a willing vendor by private treaty and at arm's length".

3.4 It will be noted that these provisions are couched in almost identical terms to those for CGT. It is worth pointing out that, whilst both sets of statute apply in strictness to the valuation of unquoted shares the principles are broadly applied in the valuation of other assets for tax purposes as well.

3.5 It is worth emphasising the fact that the amount chargeable is the loss to the estate rather than the actual asset being transferred, as outlined in the example below:

Example
If a taxpayer owns 100 shares in a company, that constitute a 100% interest, and disposes of 30 shares, for IHT purposes his estate predisposal consists of a 100% interest, and post-disposal of a 70% interest. The amount chargeable therefore will be the difference in value between a 100% interest and a 70% interest. This contrasts with the treatment for CGT purposes, where the chargeable asset is the value of a 30% minority interest all other things being equal.

4. INCOME TAX

4.1 Prior to the introduction of ITEPA 2003 the position regarding the issue of shares to an employee and the valuation of the same under Schedule E as a perquisite was a difficult area. However with effect from 16 April 2003 the taxation of employment related securities is on the basis of market value, which is defined as having the same meaning as that contained within Section 272 TCGA 1992 and with the same information standard as that contained within Section 273 TCGA 1992.

4.2 However, ITEPA 2003 introduced a new concept of restricted and unrestricted securities. The value of the shares taking into account the restrictions on the shares to be found in the Articles is known as the Actual Market Value, and the value before the restrictions are taken into account is the Unrestricted Market Value (usually shortened to "UMV"). Restrictions commonly found with regard to non-quoted shares will likely include the almost universal director's power of veto on the transfer of shares, any bad or good leaver provisions, pre-emption rights and the like.

4.3 Shares in a privately owned company are likely to be considered a restricted security by HMRC.

4.4. In practice HMRC appear to be willing to accept that in most circumstances the actual market value of restricted securities is likely to be of the order of 10-15% lower than the UMV. It should be noted however that for shares that have unusual restrictions (or no restrictions) these broad valuation parameters may not be appropriate, and each case needs to be looked at on its merits.

5. STAMP DUTY

5.1 Stamp Duty is charged on the consideration passing on a conveyance or transfer on sale. s20 Finance Act 1985 abolished stamp duty on gifts – provided there is no consideration..

5.2 The case of Stanyforth v IRC [1930] AC339 has interpreted the Stamp Duty statute as meaning the same as a sale on the open market as postulated under the original charging provisions for Estate Duty (Section 7(5) FA1894).

5.3 The principal difference between valuations for Stamp Duty and valuations for IHT and CGT is that there are no statutory prohibitions regarding the flooding of the market, and no statutory direction with regard to the information available. These factors are likely to lead to a lower value for Stamp Duty purposes than would be appropriate for either CGT or IHT. However, the times when this value differential will be material are likely to be rare.

6. INFORMATION STANDARDS

6.1. There is a long history regarding the development of the current position on information standards in valuation that is only of practical interest to full time valuers. In summary, when the Revenue changed the law after it lost the Lynall case in the early 1970's to re-establish the position that is defined in s273TCGA1992 .

6.2 The current position is that established in two cases before the Special Commissioner – Caton v Couch and Clark v Green, both heard in 1995. In these cases, which both concerned shares in the same company at broadly the same date, the holdings to be valued where 14.02% and 3%, i.e. both uninfluential minority interests.

6.3 The cases revolved around the availability or otherwise of two items of unpublished information: the latest set of results (for the period ending just before the valuation dates), and the fact that it was the intention for the company to be sold in the near future.

6.4 With regard to the 14.02% interest the Commissioner held that both pieces of information would be made available, principally because of the amount that a purchaser would need to spend to buy the interest, and valued the interest at £1.4million.

6.5 The 3% interest however was deemed not to be eligible to know information about the sale, but would have been made aware of the broad thrust of the most recent results. The Commissioner placed a value of some £168,000 on this interest.

6.6 Whilst the issue of available information is still contentious in practice the issue will usually depend upon:

- The size of the interest.
- The amount of money at stake.

6.7 In practical terms, a small holding may not give the investor any significant influence whereas a large investment may result in access to otherwise commercially confidential information and possibly a position on the board of directors or being invited to attend directors' meeting.

7. APPROACHING HMRC

7.1 What follows is a resume of the information that is normally contained in a valuation report, important caveats and a short list of pointers in specific circumstances that may prove to be effective in facilitating dealing with HMRC.

7.2 Valuation reports, whether for tax or other purposes are normally structured along the following lines:

- **Introduction –** sets out the basics of the valuation; who is undertaking it, what is the asset to be valued, at what date and in what circumstances, what is the basis of valuation and what broadly does the company do.
- **Information –** what information has the valuer used to come to an opinion, e.g. accounts, Articles, forecasts, business plans and the like. In addition, details of the research that has been undertaken into the market.
- **Caveats –** this is an important area, and details of the normal caveats to be found in valuation reports are dealt with in a section of its own below.
- **The Company –** a description of the business activities, historic and forecast results, an analysis of the balance sheet, a breakdown of the current shareholdings and the share rights as appropriate and a description of any clauses in the Articles that impinge on valuation.
- **Valuation Approach –** an outline as to which approach the valuer has used to arrive at an opinion and the reasoning.
- **Research –** this will include sections on deals and transactions in the company shares, deals involving other comparable assets, the ratings of companies in the quoted sector and the state of the sector and economy generally.
- **Opinion –** this should take the reader through the process in a way that allows them to follow the computation and understand fully where the assumptions and figures come from. The report should be dated and the opinion should refer to how long it can apply. At the end the opinion will usually have the firms' signature.
- **Appendices –** these will contain any further information regarding the financials, further detail regarding research and spreadsheets.
- **Expert Witness Reports –** in addition to all of the above, in the case of a report that is likely to be presented in court, the valuer will need to include an expert's declaration and statement of truth, and a detailed CV.

7.3 The question of caveats is a difficult area and much will depend on the circumstances of each case, but the following are the sorts of caveat that are normally appropriate in any valuation report:

- **Purpose -** the valuation opinion will be for a specific and defined purpose and cannot be relied upon for any other purpose e.g. a valuation for tax purposes (involving a hypothetical sale between anonymous parties in the statutory open market) will be very different to a valuation of the same asset in a distress situation or for M&A purposes.

- **Address -** the valuation is for the use of a specific person or entity and cannot be relied upon by anyone else.

- **Who May See the Report -** the valuation will be addressed to a specific person or entity and should not be shown to others (normally excepting professional advisors or regulatory and statutory authorities) without the written consent of the valuer, which should, of course, not be unreasonably withheld.

- **Forecasts -** all forecast in the report should be the responsibility of the client alone. The valuers' work is normally limited to a review of the forecasts to confirm that they are a reasonable basis upon which to base an opinion of value.

- **Forecasts (2) -** the valuer should take no responsibility for either the accuracy or the realisation of any forecasts, and should point out that they can frequently turn out to be wrong because of events occurring that have not been foreseen, and that these events can have a significant effect on value.

- **Opinion -** the valuer should point out the valuation opinion is just that – an opinion. Valuation is an art, and not yet an exact science and other valuers including HMRC may have a different view on value.

7.4 Finally, the following pointers may be found helpful in dealing with HMRC:

- Always provide full relevant information – if HMRC need information then it speeds thing up if this is provided at the outset. However, do not provide information that is not strictly relevant - this only causes confusion and can lead to unwanted questions.

- Check on the information available on the company in the public domain – HMRC has its' own research facilities and will look to see what is in the public domain that might have a bearing on the valuation.

- Try not to be sucked into lengthy correspondence – a phone call or meeting is likely to facilitate movement in the negotiations.

- Be aware that the Revenue valuer will likely have dealt with many hundreds of valuations and will therefore be more experienced. Set against this however is the fact that you will likely know far more about the company and its' circumstances.

- Manage your clients' expectations – only rarely is a valuation absolute, and it may well be that your valuation will not be accepted without enquiry. The upshot of that enquiry may be that a negotiated settlement needs to be reached that is different from the valuation as originally submitted. The appeals process for share valuations is cumbersome, long winded and expensive and in these circumstances, a negotiated settlement is usually preferable to litigation.

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